

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:CORP:2  
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### Legend

Distributing =

Controlled =

State A =

Year 1 =

Date 1 =

Date 2 =

Business A =

Business B =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

a =

b =

c =

d =

Dear :

This letter responds to your authorized representative's letter dated July 29, 2013, requesting rulings regarding certain Federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding whether the Distribution (defined below): (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see § 355(e)(2)(A)(ii) and Treas. Reg. § 1.355-7).

### **Summary of Facts**

Distributing, a State A corporation, was formed in Year 1. Distributing is an S corporation that elected to be an S corporation effective Date 1. Distributing owns all of

the single class of issued and outstanding stock of Controlled. Distributing and Controlled each use the accrual method of accounting. Controlled is a qualified subchapter S subsidiary ("QSub") that elected to be treated as a QSub effective Date 2. Shareholder 1, Shareholder 2, Shareholder 3, and Shareholder 4, own a percent, b percent, c percent and d percent, respectively, of the single class of issued and outstanding stock of Distributing.

Distributing conducts Business A and Controlled conducts Business B. The financial information submitted by Distributing and Controlled indicates that Business A and Business B each has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The Distribution (defined below) is motivated, in whole or substantial part, by the following corporate business purposes: (1) to isolate Business B from any potential claims from Business A creditors; and (2) to facilitate Business A borrowing, and provide expanded opportunities for Business A and Business B to obtain more favorable lines of credit and other financing (collectively, the "Corporate Business Purposes").

### **Proposed Transaction**

For what are represented to be valid business reasons, Distributing proposes to undertake the following transactions pursuant to a single plan (together, the "Proposed Transaction"):

- (i) Distributing will distribute all of the Controlled stock pro rata to its shareholders (the "Distribution"). Distributing intends that the Distribution will cause a termination of Controlled's QSub election, and that Distributing will be treated as having made a deemed transfer of Controlled's assets (including Business B assets) to Controlled in exchange for a deemed transfer of all of the Controlled stock to Distributing and Controlled's deemed assumption of certain liabilities (the "Contribution").
- (ii) Controlled will elect to be treated as an S corporation pursuant to § 1362(a).

Also, following the Proposed Transaction, Distributing expects that the members of Distributing's board of directors will also serve as members of Controlled's board of directors, and that there will be overlapping officers ("Overlapping Directors and Officers").

### **Representations**

Distributing has made the following representations with respect to the Proposed Transaction:

- (a) No part of the stock that will be distributed by Distributing in the Distribution will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (b) The five years of financial information submitted on behalf of Business A conducted by Distributing is representative of the present operations of Business A, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) The five years of financial information submitted on behalf of Business B to be conducted by Controlled is representative of the present operations of Business B, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Neither Business A conducted by Distributing nor control of an entity conducting that business will have been acquired during the five year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (e) Neither Business B conducted by Distributing and to be contributed to Controlled nor control of an entity conducting that business will have been acquired during the five year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (f) Following the Proposed Transaction, Distributing and Controlled will each continue the active conduct of Business A and Business B, respectively, independently and with its separate employees, except with respect to the Overlapping Directors and Officers.
- (g) The Distribution is being carried out for the Corporate Business Purposes. The Distribution is motivated, in whole or substantial part, by the Corporate Business Purposes.
- (h) The Proposed Transaction is not being used principally as a device for the distribution of the earnings and profits of Distributing, Controlled, or both.
- (i) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
- (j) There is no intercorporate indebtedness existing between Distributing and Controlled that was issued, acquired, or will be settled at a discount.

- (k) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (l) Neither Distributing nor Controlled will be an investment company within the meaning of § 368(a)(2)(F)(iii) and (iv).
- (m) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (n) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying the aggregation rules of § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing's stock or securities that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (o) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons (other than persons described in § 355(e)(2)(C)) will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of § 355(d)(4) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (p) The total adjusted bases of the assets transferred to Controlled by Distributing will equal or exceed the total liabilities assumed (within the meaning of § 357(d)) by Controlled in the Contribution.
- (q) The total fair market value of the assets that will be transferred to Controlled in the Contribution will exceed the sum of: (i) the amount of liabilities, if any, assumed (within the meaning of § 357(d)) by Controlled in connection with the Contribution; (ii) the amount of liabilities, if any, owed to Controlled by Distributing that are discharged or extinguished in connection with the

Contribution; and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under §361(a) without the recognition of gain) received by Distributing in connection with the Contribution. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the Contribution.

- (r) The liabilities to be assumed (within the meaning of § 357(d)) by Controlled in connection with the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
- (s) Immediately after the transaction (within the meaning of § 355(g)(4)), neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).
- (t) Distributing, Controlled, and their respective shareholders will pay their own expenses, if any, incurred in connection with the Proposed Transaction.
- (u) No property will be transferred between Distributing and Controlled in the Contribution for which an investment credit under § 46 has been or will be claimed.
- (v) Effective on Date 1, Distributing made an election under § 1362(a) to be an S corporation (within the meaning of § 1361(a)), and Distributing has continued to be an S corporation since that date.
- (w) Immediately after the Distribution, Controlled will be eligible to elect S corporation status under § 1362(a).
- (x) Controlled will elect to be treated as an S corporation effective immediately after the Distribution.
- (y) There is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

### **Rulings**

Based solely on the information submitted and the representations set forth above, we rule as follows on the Proposed Transaction:

- (1) The Distribution will cause a termination of Controlled's QSub election because Controlled will cease to be a wholly-owned subsidiary of an S corporation. For Federal tax purposes, Controlled will be treated as a new corporation acquiring all of its assets and assuming all of its liabilities from Distributing immediately before the termination of Controlled's QSub election

in exchange for the stock of Controlled, pursuant to Treas. Reg. § 1.1361-5(b)(1)(i) (§ 1361(b)(3)(B) and (C)).

- (2) The Contribution together with the Distribution will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be “a party to a reorganization” within the meaning of § 368(b).
- (3) No gain or loss will be recognized by Distributing on the Contribution (§§ 361(a) and 357(a)).
- (4) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (5) Controlled’s basis in each asset received from Distributing in the Contribution will be the same as the basis of such asset in the hands of Distributing immediately before the Contribution (§ 362(b)).
- (6) Controlled’s holding period in each asset received from Distributing in the Contribution will include the period during which such asset was held by Distributing (§ 1223(2)).
- (7) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).
- (8) No gain or loss will be recognized by (and no amount will be included in the income of) the shareholders of Distributing upon the receipt of Controlled stock in the Distribution (§ 355(a)(1)).
- (9) The basis of the stock of Distributing and Controlled in the hands of each of Distributing’s shareholders immediately after the Distribution will be the same as the basis of the Distributing stock held by each respective shareholder immediately before the Distribution, allocated in proportion to the fair market value of Distributing and Controlled in accordance with § 358(a)(1) and Treas. Reg. § 1.358-2(a)(2) (§ 358(b)(2) and (c)).
- (10) The holding period in the Controlled stock received by each of Distributing’s shareholders in the Distribution will include the holding period of the Distributing stock with respect to which it is received, provided that Distributing stock is held as a capital asset in the hands of the respective shareholder on the date of the Distribution (§ 1223(1)).
- (11) Earnings and profits, if any, will be allocated between Distributing and Controlled in accordance with § 312(h) and Treas. Reg. § 1.312-10.

- (12) Distributing's accumulated adjustments account (AAA) will be allocated between Distributing and Controlled in a manner similar to the manner in which earnings and profits of Distributing will be allocated under § 312(h) in accordance with Treas. Reg. § 1.1368-2(d)(3).
- (13) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B), and will not, in itself, render Controlled ineligible to elect to be an S corporation for its first taxable year. If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be permitted to make a subchapter S election under § 1362(a) for its first taxable year, provided that such election is made effective immediately following the termination of the original QSub election.

### **Caveats**

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the Proposed Transactions under other provisions of the Code or the regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transactions that is not specifically covered by the above rulings. In particular, except as so provided, no opinion is expressed or implied regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);
- (ii) Whether the Distribution is being used principally as a device for the distribution of earnings and profits of Distributing, Controlled, or both (see § 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or
- (iii) Whether the Distribution is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled (see § 355(e) and Treas. Reg. § 1.355-7).

### **Procedural Statements**

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by



attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the powers of attorney on file in this office, a copy of this ruling letter will be sent to the representative named therein.

Sincerely,

Joanne M. Fay  
Chief, Branch 2  
Office of Associate Chief Counsel (Corporate)

cc: